BANK OF CANADA
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Business Outlook Survey

Results of the Autumn 2015 Survey | Vol. 12.3 | 9 October 2015

The autumn Business Outlook Survey *shows that firms' expectations continue to diverge as they gradually adjust to an environment of weaker commodity prices and a lower Canadian dollar. The overall sales and investment outlook improved, owing in part to continued support from U.S. demand. However, business sentiment remains weak for firms directly and indirectly tied to the resource sector.*

Overview

- Although business sentiment remains tepid overall, forward-looking indicators of business activity improved. Supported by a generally positive outlook for the U.S. economy and a weaker domestic currency, businesses reported firmer sales expectations, especially for their foreign customers.
- Yet the adverse effects of the persistent weakness in commodity prices continue to work their way through the economy, dampening the outlook for many firms tied both directly and indirectly to the resource sector.
- Intentions to increase investment have become more widespread, particularly among firms in some service industries and in the manufacturing sector. Businesses plan to expand their staff, but hiring intentions remain modest overall, partly because of limited plans among domestically oriented firms.
- Fewer firms anticipate difficulty meeting an unexpected increase in demand, largely reflecting the effects of the commodity price shock and sluggish economic activity over recent quarters. Indicators of labour shortages remain at low levels, pointing to continued slack in the labour market.
- Firms expect input and output prices to rise at a faster pace, owing in part to renewed upward pressure from the depreciation of the Canadian dollar. Inflation expectations continue to be concentrated in the bottom half of the Bank's inflation-control range.
- Overall, firms report that credit conditions tightened somewhat over the past three months, in particular for those exposed to the energy sector.

The *Business Outlook Survey* summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of Canada's gross domestic product. The autumn 2015 survey was conducted from 20 August to 16 September 2015. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding. Additional information on the survey and its content is available on the Bank of Canada's website. The survey results summarize opinions expressed by the respondents and do not necessarily reflect the views of the Bank of Canada.

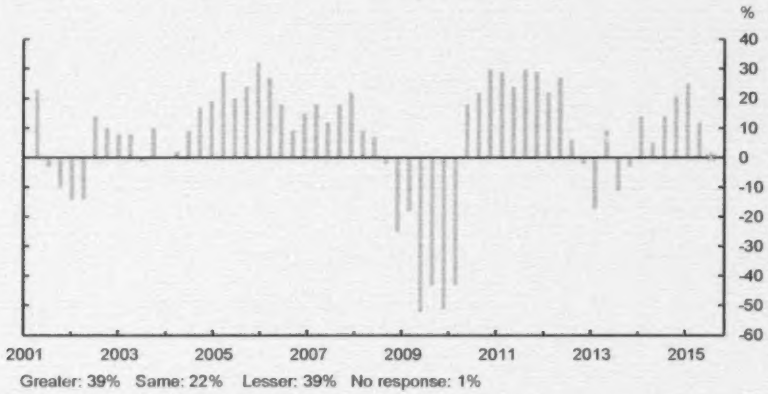
Business Activity

The balance of opinion on past sales growth continued to fall in the autumn survey and reached zero as, on average, firms experienced a flattening in sales growth over the past 12 months (**Chart 1**). Businesses in the energy-producing regions largely accounted for the drop in this indicator. However, following moderate sales expectations in the past three surveys, firms now expect, on balance, some acceleration in their sales over the next 12 months (**Chart 2**). The result masks a divergence in firms' perspectives. On the one hand, several companies have restructured and refocused their efforts, for example, through innovation or by developing online sales; in some cases, these adjustments occurred in the context of a consolidation in their industry. These firms now see themselves as better positioned to benefit from strengthening foreign demand. On the other hand, although the negative effects of the oil price shock appear to be increasingly in the past, the outlook remains weak for firms in the energy sector and supply chain, as well as those exposed to slowing household spending and diminished confidence in the affected regions.

Chart 1: **Firms saw a flattening of sales growth over the past 12 months...**

Balance of opinion[a]

Over the past 12 months, did your firm's sales volume increase at a greater, lesser or the same rate as over the previous 12 months?



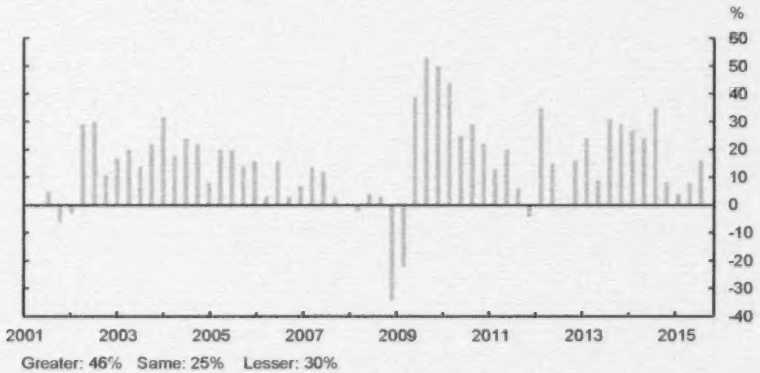
a. Percentage of firms reporting faster growth minus the percentage reporting slower growth

* Indicates a balance of opinion of zero

Chart 2: **...but expect some acceleration in sales over the next 12 months**

Balance of opinion[a]

Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser or the same rate as over the past 12 months?



a. Percentage of firms expecting faster growth minus the percentage expecting slower growth

On the upside, the majority of firms, particularly those in the manufacturing sector, anticipate a boost to their sales from the improving U.S. economy. Firms expect their exports to accelerate over the next 12 months and reported that indicators of future sales to foreign customers, such as order books and sales inquiries, have improved compared with 12 months ago. In terms of domestic demand, businesses cited only a modest improvement in indicators of future sales compared with a year ago.

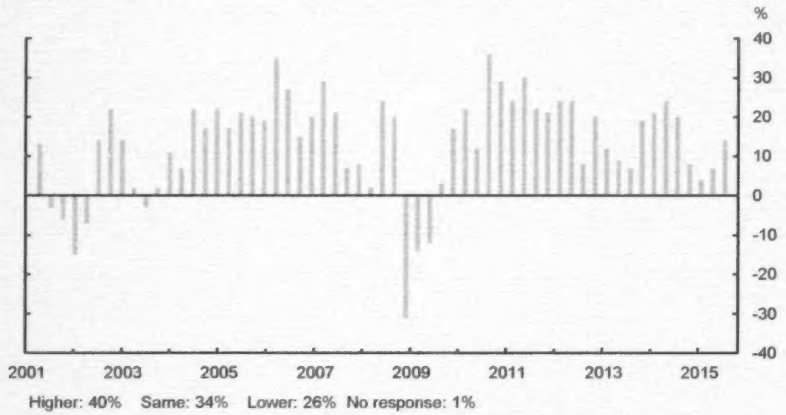
Firms across several industries reported benefits from the depreciation of the Canadian dollar over the past year. Exporters are enjoying higher margins on their U.S. sales and a lift to foreign demand from more competitive pricing abroad. Some companies are also seeing increased business related to tourism or are facing less competition in Canada from their U.S. counterparts. Others, however, particularly those in the wholesale and retail trade sector, reported that the depreciation is a challenge for them. Many had already passed higher prices for their imported inputs through to their customers but judge that, in the current competitive environment, raising prices further in response to renewed depreciation would be detrimental to their sales.

The balance of opinion on investment in machinery and equipment rose in the autumn survey, pointing to more widespread intentions to increase spending over the next 12 months (**Chart 3**). Firms in several sectors, particularly those in some service industries and in the manufacturing sector, plan to increase output or expand operations. Domestically oriented companies often reported investing to modernize their facilities or to implement new information technologies. Some exporters also referred to strengthening foreign demand as a reason. However, several firms are still holding back their investment plans, citing, for example, insufficient domestic demand. Others judged that the improvement in foreign demand for their products had to be more solidly entrenched to warrant additional investment spending.

Chart 3: **Intentions to increase investment have become more widespread...**

Balance of opinion[a]

Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower or the same as over the past 12 months?



a. Percentage of firms expecting higher investment minus the percentage expecting lower investment

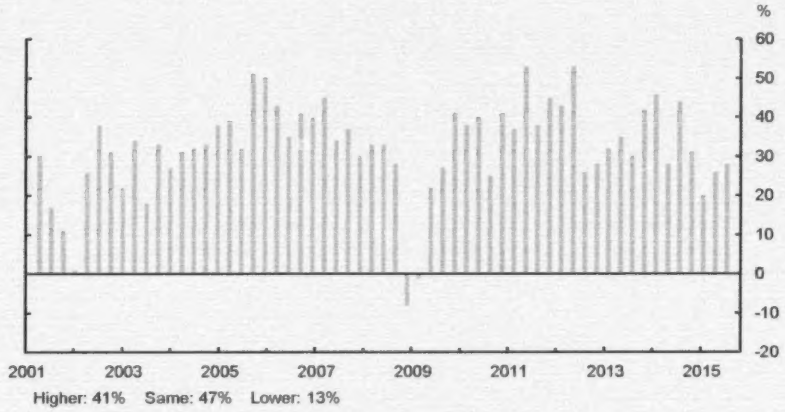
As in the summer survey, some of the exporters with improved margins from the weaker Canadian dollar indicated that they are ramping up their investment spending, while others are saving the extra margin or using it to pay down debt. A minority of firms that have to pay more for imported investment goods reported a dampening effect on their investment plans.

While intentions to increase employment over the next 12 months are positive, the balance of opinion remains modest (**Chart 4**). As in previous surveys, firms' views on employment diverge: on the one hand, plans to increase employment are more widespread among firms reporting that they are benefiting from weaker oil prices and the lower Canadian dollar. Firms attributed plans to increase their staff to an expansion of their business or firmer sales prospects. Conversely, firms for which the changing economic landscape is unfavourable indicated weak hiring intentions. Those planning to reduce employment, predominantly domestically oriented firms, often cited a lack of new projects, as well as cost containment and efficiency gains from restructuring as the main reasons.

Chart 4: ...while employment intentions remain modest

Balance of opinion[a]

Over the next 12 months, is your firm's level of employment expected to be higher, lower or the same as over the past 12 months?



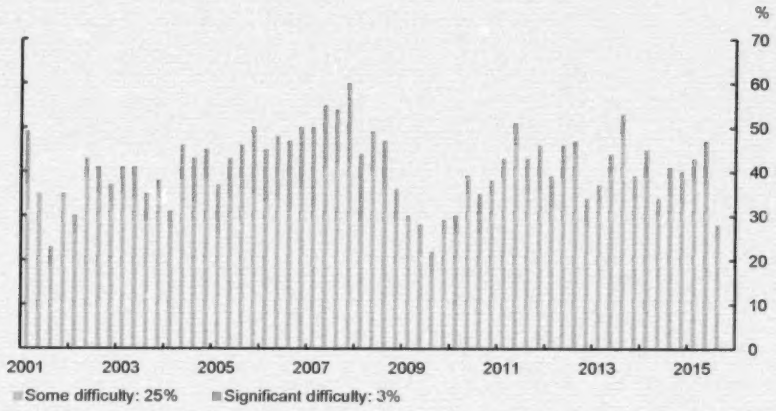
a. Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The share of firms that would have difficulty meeting an unanticipated increase in demand fell in the autumn survey, suggesting that economic slack has widened recently (**Chart 5**). This mostly reflects tepid economic activity in recent quarters, largely related to the propagation of the drop in commodity prices. Indeed, capacity pressures decreased further for firms in the Prairies and those indirectly affected by the oil price shock, which often cited weaker demand. Although many businesses report that they are benefiting from the strengthening U.S. economy, the improvement in demand conditions for these firms has not been sufficient to absorb excess capacity. On the upside, several firms also indicated that capacity pressures have dissipated over the past year because of recent investments or process improvements that have expanded their production capacity.

Chart 5: **Capacity pressures decreased, suggesting that economic slack has widened...**

How would you rate the current ability of your firm to meet an unexpected increase in demand?

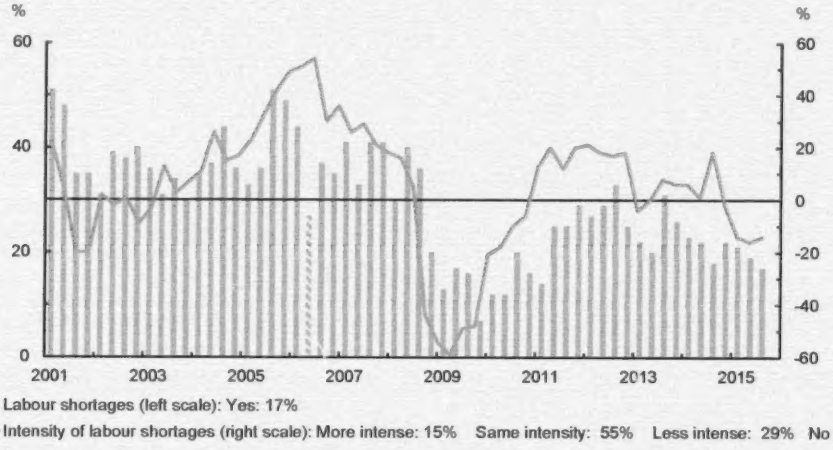


The share of firms reporting that labour shortages are restricting their ability to meet demand remains low and, on balance, firms continue to see labour shortages as less intense relative to 12 months ago (**Chart 6**). Firms in the regions and sectors exposed to declines in commodity prices indicated that it has become easier to fill positions, since layoffs in the oil and gas sector have increased the pool of available labour. Relatively unaffected firms reported little change from a year ago in the intensity of labour shortages. Overall, both indicators continue to suggest persistent labour market slack.

Chart 6: **...while both indicators of labour market shortages remain at low levels**

Labour shortages: Does your firm face any shortages of labour that restrict your ability to meet demand?

Labour shortage intensity (balance of opinion):[a] Compared with 12 months ago, are labour shortages generally more intense, less intense or about the same intensity?



a. Percentage of firms reporting more intense labour shortages minus the percentage reporting less intense shortages

The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

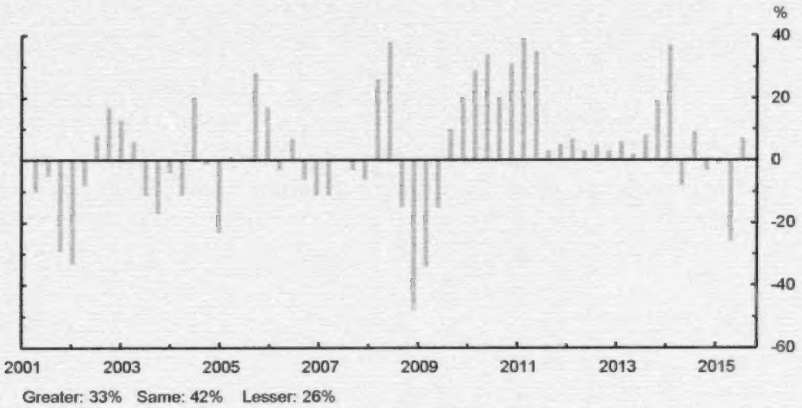
Prices and Inflation

The balance of opinion on input prices turned positive in this quarter, indicating that firms anticipate that the prices of their inputs will increase at a greater rate over the next 12 months (**Chart 7**). The reversal from last quarter was broad-based across most regions and can be largely attributed to the continued depreciation of the Canadian dollar, which firms expect to filter through to the cost of their imported inputs. Lower commodity prices partly offset some of these upward pressures, but some firms also noted increased input cost pressures from domestic sources, such as utilities.

Chart 7: **Firms expect input prices to increase at a greater rate over the next 12 months...**

Balance of opinion[a]

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser or the same rate as over the past 12 months?



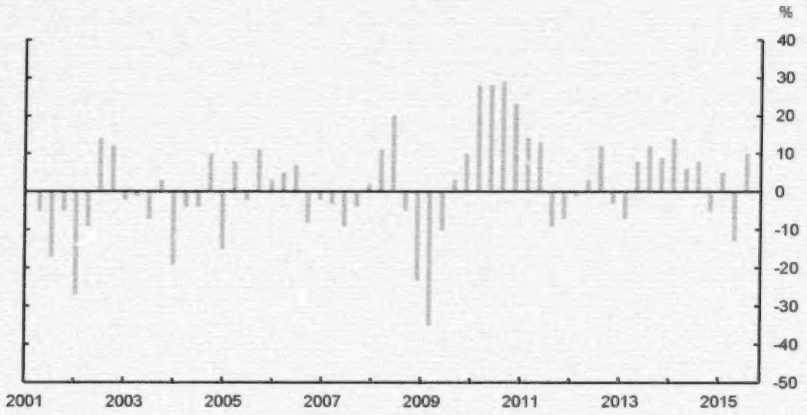
a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The balance of opinion on output prices turned positive as well, an indication that firms expect their output prices to increase at a faster pace over the next 12 months (**Chart 8**). Many businesses are planning to pass the higher costs of imported inputs, at least partially, through to their customers. At the same time, firms struggling to remain competitive and those facing sluggish demand for their goods and services see limited opportunities to increase their prices.

Chart 8: ...and anticipate output prices to increase at a faster pace, partly reflecting pressures from the depreciation of the Canadian dollar

Balance of opinion[a]

Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser or the same rate as over the past 12 months?

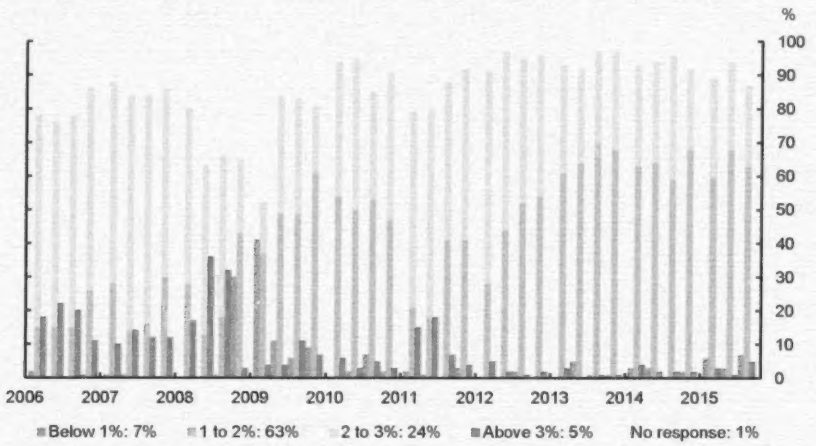


a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Overall, inflation expectations are little changed since the summer survey (**Chart 9**). A large majority of firms expect CPI inflation to remain within the Bank's 1 to 3 per cent inflation-control range over the next two years, with the majority continuing to expect inflation to remain in the lower half of that range. Businesses cited several factors, including the lack of momentum in domestic demand and lower oil prices, which are seen to be contributing to weaker inflation. The lower domestic currency and higher food prices were often reported as the main reasons for stronger inflation expectations.

Chart 9: Inflation expectations are little changed

Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?



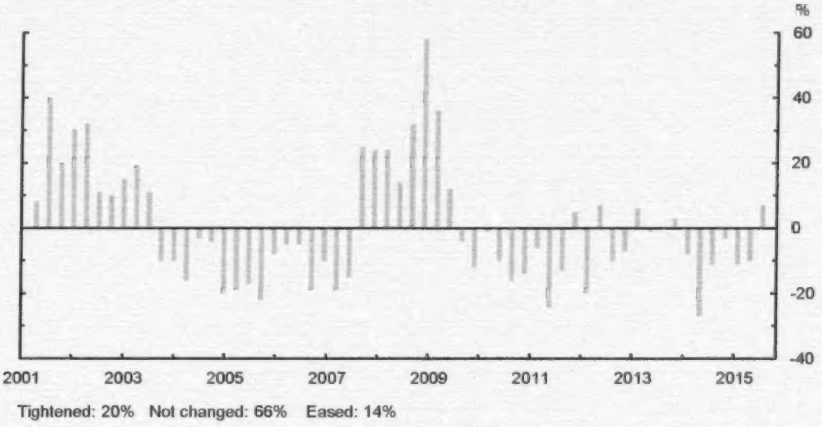
Credit Conditions

For the first time in several quarters, the balance of opinion on credit conditions turned slightly positive, indicating a tightening in credit conditions over the past three months (**Chart 10**). Businesses reporting a tightening were often tied to the energy sector, but some also pointed to firm-specific reasons or their exposure to recent volatility in global financial markets. In contrast, many of the businesses experiencing an easing in credit conditions, often in the form of lower borrowing costs, attributed the change to their strong financial position.

Chart 10: **On balance, credit conditions tightened somewhat, in particular for firms exposed to the energy sector**

Balance of opinion[a]

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



a. Percentage of firms reporting tightened minus the percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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